IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE NO. 107 OF 1995

For Approval and Signature:

HONOURABLE MR.JUSTICE R.S.GARG

HONOURABLE MR.JUSTICE M.R. SHAH

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1 Whether Reporters of Local Papers may be allowed to see the judgment ?

2 To be referred to the Reporter or not ?

3 Whether their Lordships wish to see the fair copy of the judgment ?

4 Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 or any order made thereunder ?

5 Whether it is to be circulated to the Civil Judge?

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COMMISSIONER OF INCOME-TAX - Applicant(s)
Versus
URJIT INVESTMENTS PVT. LTD. - Respondent(s)

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Appearance :
MR. B.B. NAIK for Applicant(s)-Revenue.
MR. S.N. SOPARKAR, SR. COUNSEL with MR.M.K.KAJI for Respondent(s).

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CORAM : HONOURABLE MR.JUSTICE R.S.GARG
and
HONOURABLE MR.JUSTICE M.R. SHAH

Date : 13/07/2006

ORAL JUDGMENT
(Per : HONOURABLE MR.JUSTICE R.S.GARG)

Heard Mr.B.B.Naik, learned Counsel for the Revenue, and Mr.S.N.Soparkar, learned Senior Counsel for

the respondent-Assessee.

2. Present reference has been made under Section 256(1) of the Income Tax Act at the instance of the Revenue; the question referred to the Court for its answer is “whether, the Appellate Tribunal is right in law and on facts in cancelling the disallowance of interest amounting to Rs.78,840/- when the Income Tax Officer had found that the debt itself had not become bad?”

3. The facts necessary for disposal of the present Reference are that the assessee is an Investment Company; for the Accounting Year ending on 31st December, 1984 i.e. Assessment Year 1985-86, the assessee claimed in the assessment proceedings that the interest paid by the assessee on borrowings should be allowed as deduction on accrual basis while in respect of interest receivable, the assessee be allowed to adopt cash method of accounting. The Income Tax Officer rejected the submission, the order was confirmed in appeal, but, the Tribunal held that the interest, which was added as receivable or the income which could accrue in favour of the assessee, deserved to be deducted on the ground that the debt itself had become bad, which has been so

declared by the assessee, and if the debt itself cannot be recovered, then, on the hypothetical income of interest, no tax can be levied.

4. Mr.B.B.Naik, learned Counsel for the applicant-Revenue, submitted that a fair understanding of Section-36(1)(vii), read with Section-36(2), of the Income Tax Act, 1961 (as then applicable), would make it clear that no such deduction shall be allowed in relation to bad debt or part thereof, unless such debt or part thereof has been taken into account in computing the income of the assessee of that previous year or of an earlier previous year, or represents money lent in the ordinary course of the business of banking or money lending, which is carried on by the assessee and has been written off as irrecoverable in the accounts of the assessee for that previous year. His submission is that for the previous Accounting Year 1984-85, the assessee had claimed the deduction, the deduction was disallowed, the matter was taken upto the CIT (Appeals), who also confirmed the order of the Income Tax Officer, and as the said order was not challenged further, the mandatory requirement of law that bad debt has been written off as irrecoverable in the accounts of the assessee for that previous year, is not available to the assessee and as such, the Income

Tax Officer was justified in including the interest as receivable income.

5. Mr. S. N. Soparkar, learned Senior Counsel for the respondent-Assessee, submits that if the submission of the learned Counsel for the Revenue is accepted as it is, then, because of the first illegal inclusion, the assessee would be obliged to include that unreceivable income/unreceived income in receivable income and would be asked to pay tax on hypothetical income of interest, while, in fact, the debt, according to the books of the assessee, has become bad and there are no chances of its recovery.

6. It is not in dispute before us that the assessee had shown particular loan amount advanced in favour of particular party as bad debt in the return for the Assessment Year 1984-85. True it is, that no deductions were granted in favour of the assessee, but, the fact remains that the assessee again claimed the said deduction with a further submission that the debtor is not traceable, the assessee had made an approach to the Registrar of Companies to obtain the details and addresses of the debtor, but, they were informed that the

subsequent addresses were not available with the Registrar of Companies and that the said Company had not filed its statement of affairs and other necessary documents to the Registrar of Companies. From these facts, it would clearly appear that after making all possible efforts, the assessee had informed the authority that the loan amount itself is not recoverable. If that be so, would it be prudent to hold that interest, which may accrue on an amount, which cannot be recovered, should be added in the returned income of the assessee and he be held liable to pay tax on it?

7. In the matter of ***Godhra Electricity Co. Ltd. vs. Commissioner of Income-Tax***, [(***1997) 225 I.T.R. 746***], on the facts of the case, the Court found that the tax can be levied or be recovered on income, which is actual and not hypothetical.

In the said matter, Godhra Electricity Company had enhanced the tariff and proposed recovery from the consumers on the basis of the changed tariff; the action was challenged before the Court; the Electricity Company succeeded upto the Supreme Court. During the pendency of the matter before different Courts, the Electricity Company, all through, had been showing the differential

amount as the income receivable. After the judgement of the Supreme Court, hues and cries were raised, the consumers contacted the concerned Minister and by the intervention of the State Government, the Electricity Company was asked to give up the recovery in relation to the differential amount. After it was given up by the Company, they claimed deductions, but, that was refused by the Income Tax Officer and, therefore, the matter ultimately went to the Supreme Court.

The Supreme Court, in the matter of Godhra Electricity Company, observed that income tax is a levy on income. No doubt, the Income Tax Act takes into account two points of time at which the liability to tax is attracted, viz. the accrual of the income or its receipt; but the substance of the matter is the income. According to the Supreme Court, if income does not result at all, there cannot be a tax, even though in book keeping, an entry is made about a hypothetical income, which does not materialise. The Supreme Court further observed that the assessee-Company was not in a position to take steps to recover the enhanced charges and as it had given up its right to recover that money, they could not be asked to pay tax despite entries in the books of accounts.

8. In the matter of ***Commissioner of Income Tax vs. Abbas Wazir (P.) Ltd.***, [***(2005) 274 ITR 448***], the Allahabad High Court has observed that if the recovery of the principal amount is doubtful and there is a decision on the part of the assessee to declare it as bad debt, then, interest would not accrue and interest cannot be charged on the hypothetical income of interest.

9. From these two judgements, it would clearly appear that in the given set of facts and by not applying the principles in their generality, the income, which is receivable but not received and which is accrued in a given case, may not be deemed to be an income. If the assessee in his wisdom comes to the conclusion that it would be useless to carry forward the amount of debt and also make entry relating to interest income, then, it would be an act of prudence on his part. Simply because, for a particular year, the Income Tax Officer does not allow that deletion or deduction, it would not mean that for the later year, the assessee cannot prove the fact that he had not received any income on the said bad debt.

10. It is also to be noted that the finding in relation to the bad debt is a finding based on

appreciation of facts. The Tribunal has recorded a finding that in view of the submissions made by the assessee, the debtor is traceless and despite their efforts, it became impossible for the assessee to recover the debts, therefore, the assessee was obliged to write off the debts as bad debts. If the finding of fact is that the debt had become bad debt, then, income on bad debt cannot be presumed.

11. In view of the discussion aforesaid, we answer the question referred to us by saying that the Appellate Tribunal was right in law and on facts in cancelling the disallowance of interest amounting to Rs.78,840/- even when the Income Tax Officer had found that the debt itself had not become bad. We must observe that the Tribunal has given cogent reasons to hold that the debt had become bad. The reference is answered against the Revenue and in favour of the assessee.

[R.S.Garg, J.]

[M. R. Shah, J.]

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